Case study

HODGE

Helping Julian Hodge Bank build for the future with a fast, simple IFRS 9 expected credit loss calculator

Julian Hodge Bank (JHB) is a savings bank and mortgage lender with big plans for future growth. To help support its ambitions, JHB wanted to enhance its loss calculations, allowing a quicker, easier way to calculate expected credit loss within their mortgage portfolios.

Through this case study we navigate the specific challenges faced by JHB, and what the solution was.

Challenge

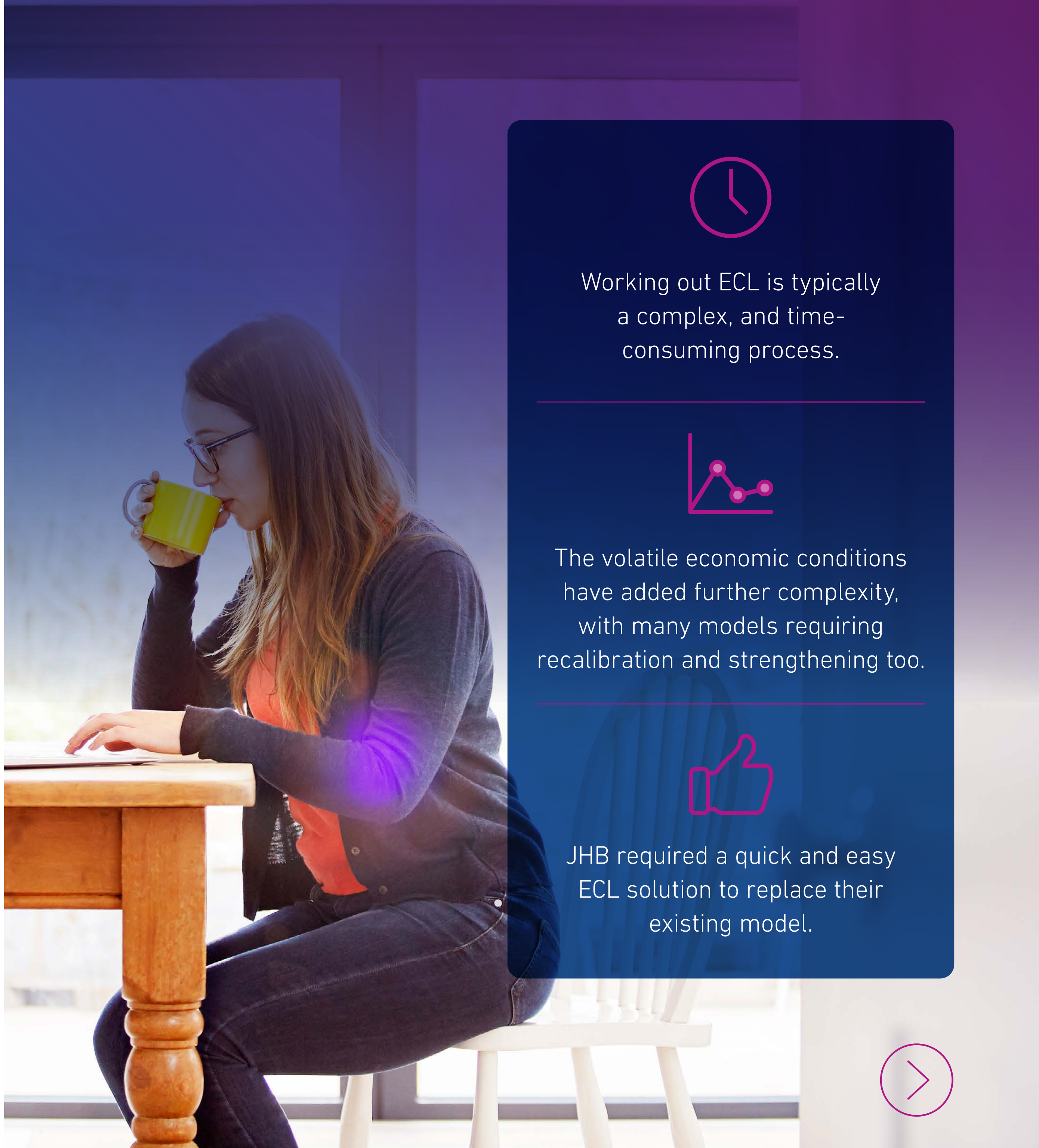
IFRS 9 regulation requires lenders to consider a wide range of historic, current and forward-looking data to calculate expected credit losses (ECL) for financial products.

While they're an important and valuable indicator of risk, many organisations find that working out ECLs is a complex, expensive and time-consuming process.

Since the adoption of the regulation there has been evidence of weaknesses in many IFRS 9 models, potentially leading to less appropriate and/or volatile ECL estimates. For example, some models have been seen to only factor in economics at a macro level, others aren't sensitive enough to changing risk profiles or don't have quick, easy management overlays whilst some rely too heavily on management overlays.

The Covid-19 pandemic has brought these shortfalls into sharp focus, with many models needing to be recalibrated and strengthened for our Covid-19 world. For example, some organisations have found that some of the economic variables they used have been subject to much more volatility than other factors e.g. GDP making their ECL calculations very unpredictable.

Whilst not directly linked to the Covid-19 pandemic, JHB required an ECL solution to replace its existing model and that its employees could use quickly and easily for expected loss calculations on current and future mortgage portfolios.



Working out ECL is typically a complex, and time-consuming process.

The volatile economic conditions have added further complexity, with many models requiring recalibration and strengthening too.

JHB required a quick and easy ECL solution to replace their existing model.

Solution

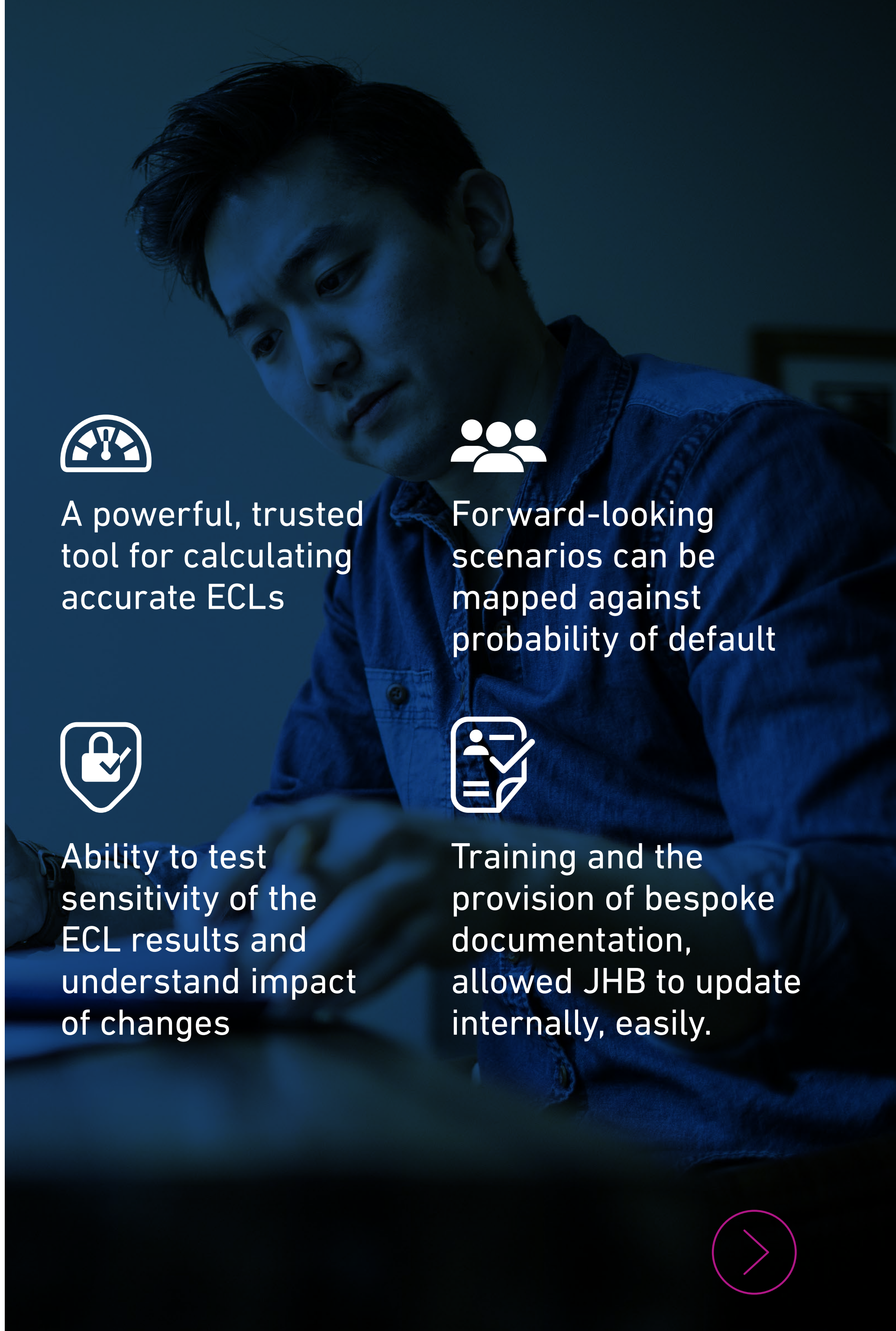
Impressed by our depth of insight and partnership approach, JHB turned to Experian for help.

We introduced our IFRS 9 Credit Loss Insight solution, driven by Credit Account Information Sharing (CAIS) data and powerful Delphi customer-level risk scores. Blending this data with regularly updated, forward-looking, probability-weighted economic scenarios, it offers a powerful, trusted tool for calculating accurate ECLs in just a few clicks.

A combination of CAIS driven insight, models developed on mortgage market and macroeconomic data and consultancy led inputs has delivered an interactive ECL calculation solution. Utilising back-casting and regression modelling, we developed a mortgage-level economic adjustment model to link forward-looking scenarios to probability of default. This gave JHB a clear view of default probabilities over 12 months and the remaining lifetime of products, based on mortgage type and risk score.

This view, coupled with parameterised inputs for loss given default, significant increase in credit risk and discounting factors, drives portfolio or account level loss calculations. The ability to flex each of the IFRS 9 model components through adjustment factors and weightings allows JHB the additional functionality to test the sensitivity of the ECL results and understand the potential impact of changes to both the assumptions and also the portfolio make up.

Alongside the tool itself, and a training session on its use, we provided bespoke documentation that allowed the company to easily update its internal policies and consultancy support in understanding the results in comparison to other lenders public reporting. Audit support was also provided, with the methodology being explained and the solution being demoed, directly to the external auditors.



Results

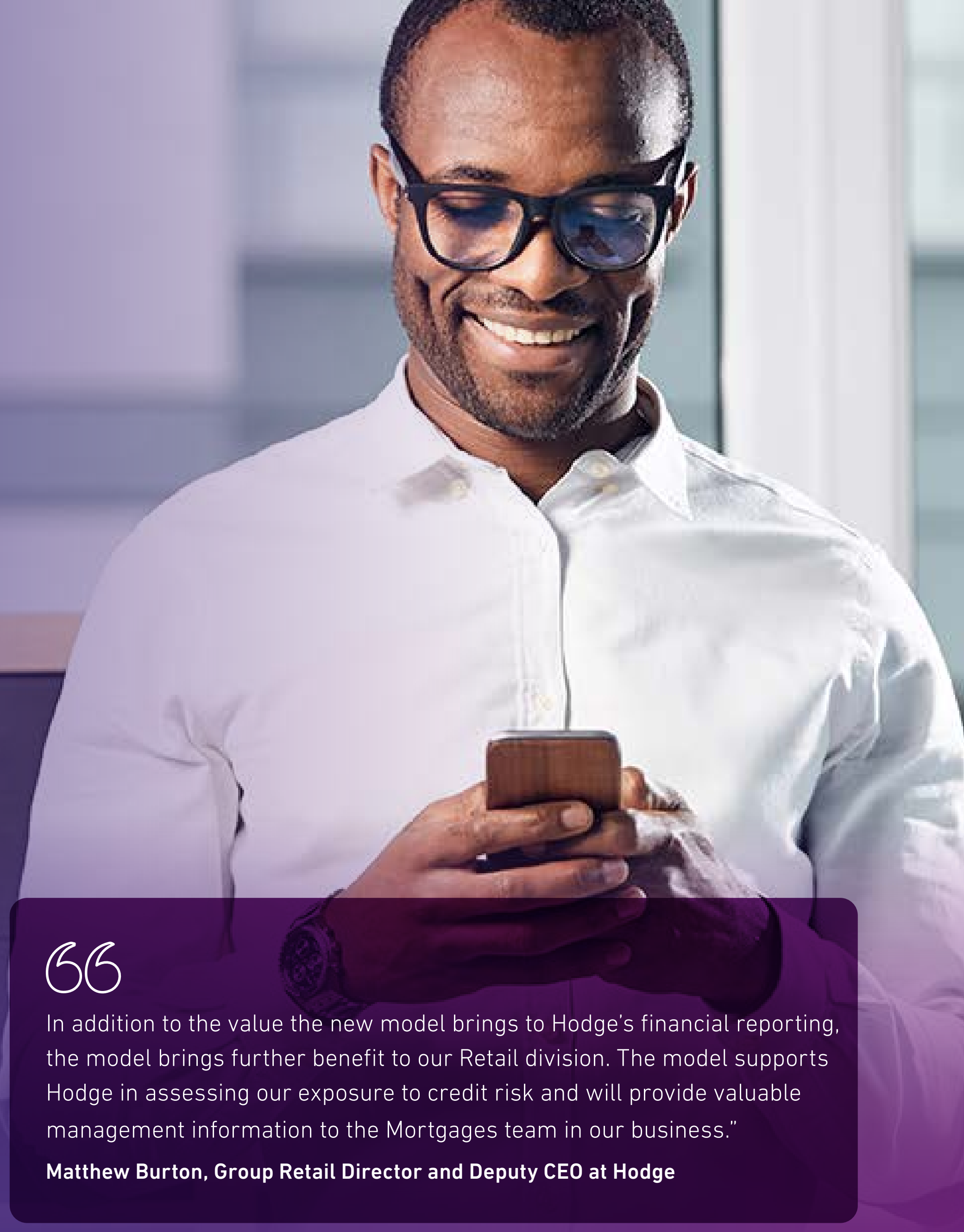
JHB now has a user-friendly, fully documented, fully IFRS 9-compliant solution that allows for rapid ECL calculations. Furthermore, its flexibility allows the company to test the effects of various economic scenarios, model assumptions and portfolio changes. JHB are able to take a view on the potential impact of future growth, supporting their overall business goals.

Driven by risk-based segmentation, and the fact JHB has a prime portfolio, the Experian model resulted in a significant reduction in ECL compared to the existing JHB solution, and provided a return on investment of over 1000%. It provides a reliable, easy to use platform which the bank can utilise on its current portfolios and on future portfolios

01 JHB saw a significant reduction in ECL

02 Experian's ECL model provided a 1,000%+ return on investment for JHB

03 JHB could quickly and easily understand the materiality of changing assumptions.



"In addition to the value the new model brings to Hodge's financial reporting, the model brings further benefit to our Retail division. The model supports Hodge in assessing our exposure to credit risk and will provide valuable management information to the Mortgages team in our business."

Matthew Burton, Group Retail Director and Deputy CEO at Hodge

JHB had a specific challenge which Experian's experts helped them understand, and solve.

Our services can be tailored to the needs of individuals to help provide solutions that best fit their specific requirements.

Experian's ECL solution helps lenders meet their IFRS 9 regulations and provides the ability to understand the materiality of assumptions and changes.

Specific benefits of our solution include:

- Powered by comprehensive CAIS data and powerful customer level delphi scores.
- Incorporates regularly refreshed economic scenarios built by industry-leading economists.
- Provides quick and easy ECL calculations.
- Updated regularly to remain compliant.
- Allows for sensitivity testing of ECL.
- Reduces time and cost compared to building bespoke models.
- Includes Audit approved documentation.
- Optional benchmarking module helps address difficult audit questions around why individual client results differ from the rest of the industry.

"I'm glad to say that Experian has successfully worked with Hodge to build a new IFRS 9 ECL calculator to replace our existing process. The new interactive ECL solution is straightforward to use and the team are pleased with the standardised input sheet which has reduced the timeframe to calculate the ECL provision. I have been impressed by Experian's Regulatory Analytics team, led by Liz Clarke and Alastair Porter, both of whom engaged with Hodge from the outset of the project. The new solution provides a credible and supportable output which is based on Experian's extensive UK wide mortgage data and forecast economic scenarios supplied by Experian's Economist team. Experian took the time to understand the nature of Hodge's products and devised tailored solutions to our later life lending and specialist buy-to-let mortgage portfolios. The team were readily available to assist with queries from our recent external audit and the model is supported by comprehensive documentation which was well received by Hodge's Audit Committee. The Finance team are really happy with the solution Experian has provided, the approach that they took to get there and the interactions that we had with them."

Jonathan James, Group Financial Controller at Hodge

Find out more

To find out how we can help you with your regulatory requirements, or broader needs, get in touch today.

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